



# ***PR 2002/1 - Income tax: Parkview Orchard Project Prospectus No 2***

 This cover sheet is provided for information only. It does not form part of *PR 2002/1 - Income tax: Parkview Orchard Project Prospectus No 2*

 This document has changed over time. This is a consolidated version of the ruling which was published on *16 January 2002*



# Product Ruling

## Income tax: Parkview Orchard Project

### Prospectus No 2

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### *Preamble*

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons and Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a ‘public ruling’ in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

### **No guarantee of commercial success**

Potential participants may wish to refer to the ATO’s Internet site at <http://www.ato.gov.au> or contact the ATO directly to confirm the currency of this Product Ruling or any other Product Ruling that the ATO has issued.

The Australian Taxation Office (ATO) **does not** sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the ‘track record’ of the management, the level of fees in comparison to similar products, how this product fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out below in the **Ruling** part of this document are available **provided that** the arrangement is carried out in accordance with the information we have been given and have described below in the **Arrangement** part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Potential participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Potential participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

### **Terms of Use of this Product Ruling**

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

## What this Product Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of persons who take part in the arrangement to which this Ruling refers. In this Ruling this arrangement is sometimes referred to as the Parkview Orchard Project Prospectus No 2, or simply as 'the Project'.

### Tax laws

2. The tax laws dealt with in this Ruling are:

- Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- Section 8-1 (ITAA 1997);
- Section 17-5 (ITAA 1997);
- Division 27 (ITAA 1997);
- Division 35 (ITAA 1997);
- Division 40 (ITAA 1997);
- Section 70-35 (ITAA 1997);
- Section 108-5 (ITAA 1997);
- Subsection 110-25(2) (ITAA 1997);
- Division 328 (ITAA 1997);
- Subsection 44(1) of the *Income Tax Assessment Act 1936* ('ITAA 1936');
- Section 82KL (ITAA 1936);
- Section 82KZL (ITAA 1936);
- Section 82KZME (ITAA 1936);
- Section 82KZMF (ITAA 1936); and
- Part IVA (ITAA 1936).

### Goods and Services Tax

3. In this Ruling all fees and expenditure referred to include Goods and Services Tax ('GST') where applicable. In order for an entity (referred to in this Ruling as a Grower) to be entitled to claim input tax credits for the GST included in its expenditure, it must be registered or required to be registered for GST and hold a valid tax invoice.

**Changes in the Law**

4. The Government is currently evaluating further changes to the tax system in response to the *Ralph Review of Business Taxation* and continuing business tax reform is expected to be implemented over a number of years. Although this Ruling deals with the taxation legislation enacted at the time it was issued, later amendments may impact on this Ruling. Any such changes will take precedence over the application of this Ruling and, to that extent, this Ruling will be superseded.

5. Taxpayers who are considering participating in the Project are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

**Note to promoters and advisers**

6. Product Rulings were introduced for the purpose of providing certainty about tax consequences for participants in projects such as this. In keeping with that intention, the Tax Office suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Ruling is issued.

**Class of persons**

7. The class of persons to whom this Ruling applies is the persons who are more specifically identified in the Ruling part of this Product Ruling and who enter into the arrangement specified below on or after the date this Ruling is made. They will have a purpose of staying in the arrangement until it is completed (i.e., being a party to the relevant Agreements until their term expires) and deriving assessable income from this involvement. In this Ruling these persons are referred to as 'Growers'.

8. The class of persons to whom this Ruling applies does not include persons who intend to terminate their involvement in the arrangement prior to its completion or who otherwise do not intend to derive assessable income from it.

**Qualifications**

9. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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## Date of effect

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11. This Ruling applies prospectively from 16 January 2002, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

12. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on that private ruling if the income year to which it relates has ended or has commenced but not yet ended. However if the arrangement covered by the private ruling has not commenced, and the income year to which it relates has not yet commenced, this Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

## Withdrawal

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13. This Product Ruling is withdrawn and ceases to have effect after 30 June 2005. The Ruling continues to apply, in respect of the tax law(s) ruled upon, to all persons within the specified class who enter into the arrangement specified below. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no change in the arrangement or in the person's involvement in the arrangement.

## Arrangement

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14. The arrangement that is the subject of this Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Product Ruling application dated 13 December 1999 and request dated 27 July 2001 for a ruling for Parkview Orchard Project Prospectus No. 2;
- Parkview Orchard Project Prospectus No. 2 dated 21 June 2001;
- **Management Agreement between ARG Management Limited ('the Responsible Entity') and each Grower received from the Applicant's representative on 17 September 2001;**
- **Allotment Agreement between the Responsible Entity and each Grower received from the Applicant's representative on 17 September 2001;**
- **Parkview Orchard Project Constitution between the Responsible Entity and Growers received from the Applicant's representative on 17 September 2001;**
- **Parkview Orchard Project Supplementary Constitution between the Responsible Entity and Growers received from the Applicant's representative on 17 September 2001;**
- Parkview Orchard Project Compliance Plan received from the Applicant's representative on 17 September 2001;
- Operations Agreement between the Responsible Entity and Parkview Orchard Management Limited received from the Applicant's representative on 17 September 2001;
- Heads of Agreement between the Responsible Entity, Australian Rural Group Limited, Parkview Orchard Management Limited and Spurlet International Pty Limited received from the Applicant's representative on 17 September 2001;
- Draft Lease Agreement between Parkview Orchard Properties Limited and Australian Rural Group Limited (the Custodian) received from the Applicant's representative on 17 September 2001;
- Draft Sublease Agreement between the Custodian and the Responsible Entity received from the Applicant's representative on 17 September 2001;
- Custodian Agency Agreement between ARG Management Limited and Australian Rural Group Limited received from the Applicant's representative on 17 September 2001;

- A list of Investors accepted into the Project before 30 June 2001, together with site maps detailing the allotments to be allocated on the 'Cawarrie' and 'Roseville South' properties, received from the Applicant on 24 July 2001;
- Correspondence dated 1 and 13 March 2000, 23 January 2001, 19 February 2001, 6, 15, and 19 March 2001, 18, 21 June 2001, 6, 12 and 30 July 2001, 3 August 2001, 19 and 31 October 2001 and 14 November 2001 from the ATO to the Applicant's representative; and
- Letters of reply to the ATO dated 2 and 22 March 2000, 11 December 2000, 6 February 2001, 3, 14, 17, 21 and 23 March 2001, 13, 19 June 2001, 6, 9 and 27 July 2001, 17 September 2001, 2 and 12 November 2001 from the Applicant's representative.

**Note: certain information received from the applicant has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.**

15. The documents highlighted above are those that the Growers enter into. For the purpose of describing the arrangement to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Grower, or any associate of the Grower, will be party to.

16. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements. The effect of the agreements may be summarised as follows.

### Overview

17. This arrangement is called 'Parkview Orchard Project Prospectus No 2'.

Location	The project property is located in the Central West of New South Wales, approximately 6km from Forbes.
Type of business each participant is carrying on	Commercial growing of fruit trees.
Number of hectares under cultivation	Stage 1 consists of 34 planted hectares at "Cawarrie" and 60 hectares to be developed at "Roseville South"
Name used to describe the	Parkview Orchard Project Prospectus

Product	No. 2
Size of the licensed area per allotment	0.1 hectares (0.04 at “Cawarrie” and 0.06 at “Roseville South”)
Number of trees per hectare	An average of 770 per hectare with 965 at “Cawarrie” and 740 at “Roseville South”
Expected production per 0.1 hectare allotment	Cherries – 70 kg (14 cases) Plums – 160 kg (16 cases) Pears – 67.5 kg (15 trays) Apples – 72 kg (4 cases)
Term of the project	19 years
Initial cost	\$8,975 per allotment payable in advance on application for Management and Licence fees for the first 13 months, plus \$1,000 (per allotment) for one Ordinary share in the Landowning company
Initial cost on a per hectare basis	\$99,750
Ongoing costs	Year 2 – a Management fee of \$600, a Picking, Packing and Marketing fee of \$400 and a Licence fee of \$110. Year 3 – a Management fee of \$700, a Picking, Packing and Marketing fee of \$600 and a Licence fee of \$110. Year 4 – a Management fee \$1,000 a Picking, Packing and Marketing fee of \$1,100 and a Licence fee of \$110. Year 5 onwards - a Management fee of \$14 per tree and a Picking, Packing and Marketing fee of \$14 per case or \$8 per tray and a Licence fee of \$110. These fees and the Licence fees, from year 2, are to be indexed up with the CPI (All Groups).
Other costs	Growers will be charged for the cost of all insurance except Public Liability Insurance.

18. It is planned that the Parkview Orchard will be developed over a number of stages. Interests in Stage 1 of the Project consists of the licence of an existing orchard, ‘Cawarrie’, together with the licence of

a second new orchard that is to be constructed at 'Roseville South'. It is planned that the 'Roseville South' orchard will be substantially completed by 30 June 2002.

19. The orchard land is leased to the Custodian who subleases to the Responsible Entity. The Responsible Entity will licence to each Grower their own separate identifiable orchard on which the Grower will conduct their business of growing fruit trees. A licence fee is payable for the granting of the licence.

20. It is proposed the Growers purchase the fruit trees and irrigation system that is on their licensed area in the Roseville South orchard and that they licence the trees on their licensed area in the Cawarrie Orchard. Growers then enter into a contract with the Responsible Entity for the management, picking, packaging, marketing and harvesting of the fruit. Growers will be allocated trees on each of the properties but share in the pooled proceeds from all properties.

21. The minimum individual holding is one allotment totalling 0.1 hectares of land. Each allotment will consist of 0.04 hectares of land at Cawarrie planted with 31 trees and 0.06 hectares of land at Roseville South which will be planted with 46 trees. Currently, Cawarrie orchard covers 40 hectares and 34 hectares are planted with 32,252 assorted fruit trees. Roseville South covers 60 hectares and has been partially developed by the landowner with one of the two bores sunk and 15,125 trees planted.

22. The maximum number of allotments that will be licensed to Growers is 479 out of the 1,000 allotments offered under Prospectus No. 2. The Responsible Entity will retain 370 allotments and 151 allotments were allocated under Prospectus No. 1. A Grower's trees on Roseville South will not be planted until after a Grower has been accepted into the Project. Each Grower's allotment will be identified in their Management Agreement. The Project will use the latest available computer controlled 'trickle' irrigation system to apply water to the plants according to current regulated Deficit Irrigation principals, potentially using substantially less water than is provided for in the water licences.

## **Management Agreement and Allotment Agreements**

23. Growers will make payments toward the Project under the Management Agreement and Allotment Agreements that are to be executed no later than 20 July 2002 being for licence fees, management fees, payments for the acquisition and licence of trees and picking, packing and marketing fees. Under the Management Agreement the Responsible Entity is entitled to an incentive fee where the fruit attributable to the Grower's allotment exceeds Prospectus

projections. This fee will be 50% of the gross proceeds received from the sale of fruit that exceed sale projections (clause 6.4).

24. The Responsible Entity grants each Grower a licence of an area. A Grower must not:

- use or permit any other person to use their licensed area for any purpose other than that of commercial horticulture and the Project; or
- erect any building or construction (whether temporary or permanent) on their licensed area, except with the approval of the Lessor and for the purpose of commercial horticulture and the Project.

25. In return for the payment of licence fees to the Responsible Entity, each Grower may use and occupy their licensed area during the term of the Licence. Each Grower and their invitees may also use the common areas of the Project.

26. At the expiration, or sooner determination of the term of the licence, each Grower will yield up to the Responsible Entity the allotted area in good condition.

27. Each Grower appoints the Responsible Entity to establish and maintain the orchard and the Project on the licensed area(s) and to arrange the harvest of the fruit grown on the licensed area(s). The Responsible Entity is required to perform these services according to good horticultural practices and may provide these services directly or through consultants or other specialists engaged at the Responsible Entity's expense. The Responsible Entity will obtain insurance against public risk in respect of the orchard and, if requested by a Grower in writing, use its best efforts to arrange insurance of the licensed area against damage by fire on behalf of the Grower.

28. A Grower may carry out his or her own weeding and the Responsible Entity may, in this event, reduce the fees payable by the Grower to the Responsible Entity (clause 5.1 of the Management Agreement). Growers may also elect to have their trees harvested separately or elect to take the produce from the harvest under clauses 5.2 and 5.3, respectively, of the Management Agreement. Any Grower who makes an election under clauses 5.1, 5.2 or 5.3 of the Management Agreement is outside the arrangement to which this Ruling applies and will be unable to rely on this Ruling.

29. The Management Agreement authorises the Responsible Entity to market produce as agent of the Growers (clause 4.3 of the Management Agreement). Growers who do not contribute the fruit proceeds from their allotment(s), in any particular income year, will not share in the income from the sale of pooled fruit proceeds referable to that year.

## Fees

30. The Growers will make the following payments per allotment:

- a Management fee of \$8,865 to ARG Management Ltd for management of the orchard attributable to the first 13 months, starting from execution of the Management Agreement. This fee includes management costs of \$7,008 and capital costs of \$1,857 of which \$1,098 will be for irrigation costs, \$651 for the purchase and establishment of trees and \$108 for non-deductible capital costs;
- a Licence fee of \$110 (Year 1) to the Responsible Entity for the granting of the licence to the Grower attributable to the first 13 months, starting from execution of the Allotment Agreement.

31. The Growers will make the following payments per licensed area in subsequent years for the nineteen-year Project:

- a Management fee of \$600 and a Picking, Packing and Marketing fee of \$400 (Year 2) to the Responsible Entity for the period beginning on the first day of the 14<sup>th</sup> month after the execution of the Management Agreement and ending a further 11 months later. These fees must be paid by the commencement of Year 2.
- Licence fee to the Responsible Entity for the period beginning on the first day of the 14<sup>th</sup> month after the execution of the Allotment Agreement and ending a further 11 months later (Year 2). The Licence fees are \$110 each year, indexed up by the relevant number of times with CPI (All Groups) Sydney from and including year 2. The Licence fees are payable annually in arrears from the proceeds of gross income from the Grower's allotment or by the Grower where there is insufficient income available to pay the fees;
- a Management fee \$700 and a Picking, Packing and Marketing fee of \$600 (Year 3) to the Responsible Entity for the 12 month period beginning the day after the end of year 2;
- a Management fee \$1,100 and a Picking, Packing and Marketing fee of \$1,300 (Year 4) to the Responsible Entity for the 12 month period beginning the day after the end of year 3;

- Year 5 - a Management fee of \$14 per tree and a Picking, Packing and Marketing fee of \$14 per case or \$8 per tray and increased the appropriate number of times in accordance with CPI from 30 June 2001.

32. The financial projections at pages 10 and 11 of Prospectus No. 2 estimate a substantial crop will be produced from year 1.

### **Finance**

33. Growers can fund their participation in the Project themselves, or borrow from an unassociated lending body.

34. This Ruling does not apply if a Grower enters into a finance agreement that includes or has any of the following features:

- there are split loan features of a type referred to in Taxation Ruling TR 98/22;
- there are indemnity arrangements or other collateral agreements in relation to the loan designed to limit the borrower's risk;
- 'additional benefits' are or will be granted to the borrowers for the purpose of section 82KL or the funding arrangements transform the Project into a 'scheme' to which Part IVA may apply;
- the loan or rate of interest is non-arm's length;
- repayments of the principal and payments of interest are linked to the derivation of income from the Project;
- the funds borrowed, or any part of them, will not be available for the conduct of the Project but will be transferred (by any mechanism, directly or indirectly) back to the lender, or any associate of the lender;
- lenders do not have the capacity under the loan agreement, or a genuine intention, to take legal action against defaulting borrowers; or
- entities associated with the Project, are involved or become involved, in the provision of finance to Growers for the Project.

## Ruling

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### Application of this Ruling

35. This Ruling applies only to Growers who are accepted to participate in the Project on or before 20 July 2002 and who have executed a Management Agreement and an Allotment Agreement before that date. The Grower's participation in the Project must constitute the carrying on of a business of primary production.

36. A Grower is not eligible to claim any tax deductions until the Grower's application to enter the Project is accepted and the Project has commenced.

### Important Note

37. Where a Grower is accepted to participate in the project on or before 30 June 2002, references in the following paragraphs to the first, second or third years are references to the income years ended 30 June 2002, 30 June 2003 and 30 June 2004 respectively.

38. Where a Grower is accepted to participate in the project between 1 July 2002 and 20 July 2002 (inclusive), references in the following paragraphs to the first, second or third years are references to the income years ended 30 June 2003, 30 June 2004 and 30 June 2005 respectively.

### The Simplified Tax System ('STS')

#### Division 328

39. For a Grower participating in the Project, the recognition of income and the timing of tax deductions is different depending on whether the Grower is an 'STS taxpayer'. To be an 'STS taxpayer' a Grower:

- must be eligible to be an 'STS taxpayer'; and
- must have elected to be an 'STS taxpayer'.

### Qualification

40. This Product Ruling assumes that a Grower who is an 'STS taxpayer' is so for the income year in which their participation in the Project commences. A Grower may become an 'STS taxpayer' at a later point in time. Also, a Grower who is an 'STS taxpayer' may choose to stop being an 'STS taxpayer', or may cease to be eligible to be an 'STS taxpayer', during the term of the Project. These are contingencies relating to the circumstances of individual Growers that

cannot be accommodated in this Ruling. Such Growers can ask for a private ruling on how the taxation legislation applies to them.

### **Prepaid fees**

41. For a Grower who is accepted to participate in the Project, the prepaid Management fee, prepaid Picking, Packing and Marketing fee and prepaid Licence fee incurred in the first income year will be subject to the prepayment rules in sections 82KZME and 82KZMF.

42. If the income and expenditure projections supplied by the applicant for this Product Ruling are met, assessable income derived by Growers under the agreement will exceed allowable deductions attributable to the agreement in the second and third income years. For income years where assessable income exceeds allowable deductions, sections 82KZME and 82KZMF will not apply (paragraphs 82KZME(1)(b) and 82KZME(3)(a)).

43. Instead, for those income years, the timing and amount of deductions for the prepaid Management fees and the prepaid Picking, Packing and Marketing fees will be determined under sections 82KZMA to 82KZMD (for Growers who are not 'STS taxpayers') or sections 328-105 and 82KZM (for Growers who are 'STS taxpayers'). The application or otherwise of these prepayment rules are explained in paragraphs 89 to 112.

44. In this context, a prepayment refers to advance expenditure incurred by a Grower in return for the doing of a thing that will not be wholly done in the year in which the expenditure is incurred.

## **Tax outcomes for Growers who are not 'STS taxpayers'**

### **Assessable Income - section 6-5**

45. That part of the gross sales proceeds from the Project attributable to the Grower's produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

46. The Grower recognises ordinary income from carrying on the business of growing fruit at the time that income is derived.

### **Trading stock - section 70-35**

47. During the term of the Project a Grower who is not an 'STS taxpayer' may hold picked fruit that will constitute trading stock on hand. Where, in an income year, the value of trading stock on hand at the *end* of an income year exceeds the value of trading stock

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on hand at the *start* of an income year a Grower must include the amount of that excess in assessable income.

48. Alternatively, where the value of trading stock on hand at the *start* of an income year exceeds the value of trading stock on hand at the *end* of an income year, a Grower may claim the amount of that excess as an allowable deduction.

49. During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

### **Deductions for Management fees, Picking, Packing and Marketing fees, and Licence fees - section 8-1**

50. A Grower who is not an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

<b>Fee Type</b>	<b>ITAA 1997 Section</b>	<b>Year ended 30 June 2002</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>
<b>Management Fee</b>	8-1	Amounts must be calculated – See Notes (i), (ii) & (iii) (below)	\$600 + CPI – See Notes (i), (ii) & (iv) (below)	\$700 + CPI – See Notes (i), (ii) & (iv) (below)
<b>Picking, Packing &amp; Marketing Fee</b>	8-1	Nil	\$400 – See Notes (i), (ii) & (iv) (below)	\$600 – See Notes (i), (ii) & (iv) (below)
<b>Licence Fee</b>	8-1	\$110 – See Notes (i), (ii) & (iv) (below)	\$110 + CPI – See Notes (i) & (ii) (below)	\$110 + CPI – See Notes (i) & (ii) (below)

#### **Notes:**

- (i) If a Grower is accepted into the Project between 1 July 2002 and 20 July 2002, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (ii) If the Grower is registered or required to be registered for GST, outgoings need to be adjusted where relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 134;

- (iii) For Growers who are not 'STS taxpayers' the first year's Management fee of \$7,008 as shown in paragraph 30 above is **NOT** deductible in full in the year incurred. The deduction for these fees must be determined using the formula in subsection 82KZMF(1) (see below);

$$\text{Expenditure} \quad X \quad \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

The Responsible Entity will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 135). The meaning of 'eligible service period' is explained in paragraph 97.

- (iv) The Management Agreement requires the Management fee and the Picking, Packing and Marketing fee to be prepaid for the second year onwards and the Allotment Agreement requires the first year's Licence fee to be prepaid (from the second year, Licence fees are paid in arrears). For a Grower who acquires the minimum allocation, each of the prepaid fees in these respective income years will be less than \$1,000.

For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in the year in which it is incurred (see Example 3 at paragraph 136).

If a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's first year's Licence fee, and second and third year's prepaid Management fee and Picking, Packing and Marketing fee may be \$1,000 or more. Where this occurs in relation to the first year's prepaid Licence fee, such Growers **MUST** apportion the deduction using the formula in subsection 82KZMF(1) above. If sections 82KZME and 82KZMF do not apply in the second and third years (see paragraph 42 above), such Growers determine the deduction for the prepaid Management fees and the prepaid Picking, Packing and Marketing fees, under sections 82KZMA to 82KZMD. The

application of these provisions is shown at Explanations paragraphs 102 to 106.

### **Deductions for capital expenditure - Division 40**

51. A Grower who is not an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation) and for acquiring and planting the fruit trees. All deductions shown in the following Table are determined under Division 40.

52. In the first income year Growers will also incur capital expenditure of \$108 per allotment that cannot be claimed as a deduction under any of the provisions of the ITAA 1997.

<b>Fee type</b>	<b>ITAA 1997 section</b>	<b>Year ended 30 June 2002</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>
<b>Water facility (e.g., irrigation, dam, bore, etc)</b>	40-515	\$366 - see Notes (v), (vi) & (vii) below	\$366 - see Notes (v), (vi) & (vii) below	\$366 - see Notes (v), (vi) & (vii) below
<b>Establishment of horticultural plants (fruit trees)</b>	40-515	see Notes (v), (vi) & (viii) below	see Notes (v), (vi) & (viii) below	see Notes (v), (vi) & (viii) below

#### **Notes:**

- (v) Where a Grower is accepted into the Project between 1 July 2002 and 20 July 2002 the deductions shown in the above table will be available in the next financial year i.e., substitute 30 June 2002, 2003 and 2004 with 30 June 2003, 2004 and 2005 respectively;
- (vi) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27. See Example 1 at paragraph 134;
- (vii) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. A deduction is available under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540);

- (viii) The fruit trees are a ‘horticultural plants’ as defined in subsection 40-525(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for ‘horticultural plants’ is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the fruit trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the Grower that is attributable to their establishment. The fruit trees have an ‘effective life’ of greater than 13 but fewer than 30 years for the purposes of section 40-545. This results in a straight-line write-off at a rate of 13%. The deduction is allowable when the fruit trees enter their first commercial season (section 40-530, item 2).

Growers are not eligible to claim a deduction under these provisions for the trees already established on the Cawarrie Orchard. The applicant has advised that expenditure attributable to the establishment of these trees has been fully written off by the landowner. The Responsible Entity will inform Growers when the fruit trees established on the Roseville South Orchard enter their first commercial season.

### **Tax outcomes for Growers who are ‘STS taxpayers’**

#### **Assessable Income - section 6-5**

53. That part of the gross sales proceeds from the Project attributable to the Grower’s produce, less any GST payable on those proceeds (section 17-5), will be assessable income of the Grower under section 6-5.

54. The Grower recognises ordinary income from carrying on the business of growing fruit at the time the income is received (paragraph 328-105(1)(a)).

#### **Trading stock - section 328-285**

55. During the term of the Project a Grower who is an ‘STS taxpayer’ may hold picked fruit that will constitute trading stock on hand. Where, the difference between the value of all of a Grower’s trading stock at the start of an income year and a reasonable estimate of it at the end of an income year, is less than \$5,000, the Grower does not have to account for that difference under the ordinary trading stock rules in Division 70 (subsection 328-285(1)).

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56. Alternatively, a Grower who is an 'STS taxpayer' may instead choose to account for trading stock in an income year under the provisions of Division 70 (subsection 328-285(2)).

57. During each year of the Project the Manager will provide the Grower with sufficient information to enable the Grower to determine the value of trading stock on hand at the end of the relevant income year.

### **Deductions for Management fees, Picking, Packing and Marketing fees, and Licence fees - sections 8-1 and 328-105**

58. A Grower who is an 'STS taxpayer' may claim tax deductions for the following revenue expenses:

<b>Fee Type</b>	<b>ITAA 1997 Sections</b>	<b>Year ended 30 June 2002</b>	<b>Year ended 30 June 2003</b>	<b>Year ended 30 June 2004</b>
<b>Management Fee</b>	8-1 & 328-105	Amounts must be calculated – See Notes (ix), (x) & (xi) (below)	\$600 + CPI – See Notes (ix), (x) & (xii) (below)	\$700 + CPI – See Notes (ix), (x) & (xii) (below)
<b>Picking, Packing &amp; Marketing Fee</b>	8-1 & 328-105	Nil	\$400 – See Notes (ix), (x) & (xii) (below)	\$600 – See Notes (ix), (x) & (xii) (below)
<b>Licence Fee</b>	8-1 & 328-105	\$110 – See Notes (ix), (x) & (xiii) (below)	\$110 + CPI – See Notes (ix) & (x) (below)	\$110 + CPI – See Notes (ix) & (x) (below)

#### **Notes:**

- (ix) If a Grower is accepted into the Project between 1 July 2002 and 20 July 2002, the years ended 30 June 2003, 2004 and 2005 must be substituted for the years shown in the above table;
- (x) If the Grower is registered or required to be registered for GST, outgoings need to be adjusted where relevant for GST (e.g., input tax credits). See Example 1 at paragraph 134;
- (xi) For a Grower who is an 'STS taxpayer' the first year's Management fee of \$7,008 as shown in paragraph 30 above is **NOT** deductible in full in the year incurred. The deduction for these fees must be apportioned using the formula in subsection 82KZMF(1) (see below);

Expenditure X Number of days of eligible service period in the year of income  
Total number of days of eligible service period

The Responsible Entity will inform Growers of the number of days in the 'eligible service period' in the first expenditure year. This figure is necessary to calculate the deduction allowable for the fees incurred. (See Example 2 at paragraph 135). The meaning of 'eligible service period' is explained in paragraph 97.

- (xii) The Management Agreement requires the Management fee and the Picking, Packing and Marketing fees to be prepaid for the second year onwards and the Allotment Agreement requires the first year's Licence fee to be prepaid (from the second year, Licence fees are paid in arrears). For a Grower who acquires the minimum allocation, the amount of these prepaid fees in these respective income years will be less than \$1,000.

For the purposes of this Project, an amount of less than \$1,000 is 'excluded expenditure'. 'Excluded expenditure' is an 'exception' to the prepayment rules and is deductible in the year in which it is paid (see Example 3 at paragraph 136).

If a Grower acquires more than the minimum allocation in the Project, the amount of the Grower's first year's Licence fees and second and third year's prepaid Management fees and Picking, Packing and Marketing fees may be \$1,000 or more. Where this occurs in relation to the first year's prepaid Licence fee, such Growers **MUST** determine the deduction using the formula in subsection 82KZMF(1) above. If sections 82KZME and 82KZMF do not apply in the second and third years (see paragraph 42 above), such Growers can claim an immediate deduction under paragraph 328-105(1)(b) for the amount of the prepaid Management fees and the prepaid Picking, Packing and Marketing fees that have been paid by, or on behalf of, the Grower. Where the fees are incurred as required by the Project's agreements, section 82KZM will not apply to apportion this amount (see paragraphs 107 to 112).

**Deductions for capital expenditure - Subdivisions 328-D and 40-F**

59. A Grower who is an 'STS taxpayer' will also be entitled to tax deductions relating to water facilities (e.g., irrigation) and for acquiring and planting the fruit trees. An 'STS taxpayer' may claim deductions in relation to water facilities under Subdivision 40. If the 'water facility' expenditure is on a 'depreciating asset' used to carry on the business, they may choose to claim deductions under Division 328. Deductions for the fruit trees must be determined under Subdivision 40-F.

60. The deductions shown in the following Table assume, for representative purposes only, that a Grower has either chosen to or can only claim deductions for expenditure on water facilities under Subdivisions 40-F and not under Division 328. If the expenditure has been incurred on 'depreciating assets' and is claimed under Division 328, the deduction is determined as discussed in Note (xv) below.

61. Under Division 328, if the 'cost' of a 'depreciating asset' at the end of the income year is less than \$1000 (a 'low-cost asset'), it can be claimed as an immediate deduction when first used or 'installed ready for use'. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income.

62. In the first income year Growers will also incur capital expenditure of \$108 per allotment that cannot be claimed as a deduction under any of the provisions of the ITAA 1997.

Fee type	ITAA 1997 section	Year ended 30 June 2002	Year ended 30 June 2003	Year ended 30 June 2004
<b>Water facility (e.g., irrigation, dam, bore, etc.)</b>	40-515	\$366 - see Notes (xiii), (xiv) & (xv) below	\$366 - see Notes (xiii), (xiv) & (xv) below	\$366 - see Notes (xiii), (xiv) & (xv) below
<b>Establishment of horticultural plants (fruit trees)</b>	40-515	see Notes (xiii), (xiv) & (xvi) below	see Notes (xiii), (xiv) & (xvi) below	see Notes (xiii), (xiv) & (xvi) below

**Notes:**

- (xiii) Where a Grower is accepted into the Project between 1 July 2002 and 20 July 2002 the deductions shown in the above table will be available in the next financial

year i.e., substitute 30 June 2002, 2003 and 2004 with 30 June 2003, 2004 and 2005 respectively;

- (xiv) If the Grower is registered or required to be registered for GST, amounts of capital expenditure would need to be adjusted as relevant for GST (e.g., input tax credits): Division 27: see Example 1 at paragraph 134;
- (xv) Any irrigation system, dam or bore is a 'water facility' as defined in subsection 40-520(1), being used primarily and principally for the purpose of conserving or conveying water. If the expenditure is on a 'depreciating asset' (the underlying asset), the Grower may choose to claim a deduction under either Division 328 or Subdivision 40-F. For the purposes of Division 328, each Grower's interest in the underlying asset is itself deemed to be a 'depreciating asset'. If the 'cost' apportionable to that deemed 'depreciating asset' is less than \$1000, the deemed asset is treated as a 'low-cost asset' and that amount is deductible in full when the underlying asset is first used or 'held' ready for use. This is so provided the Grower is an 'STS taxpayer' for the income year in which it starts to 'hold' the asset and the income year in which it first uses the asset or has it 'installed ready for use' to produce assessable income. If the deemed asset is not treated as a 'low-cost asset', the tax deduction allowable in the year ended 30 June 2002 or 30 June 2003 is determined by multiplying its 'cost' by half the relevant STS pool rate. At the end of the year, it is allocated to the relevant STS pool and in subsequent years the full pool rate will apply. If the expenditure is not on a 'depreciating asset', or if they choose to use Subdivision 40-F, Growers must claim deductions under Subdivision 40-F, paragraph 40-515(1)(a). This deduction is equal to one third of the capital expenditure incurred by each Grower on the installation of the 'water facility' in the year in which it is incurred and one third in each of the next 2 years of income (section 40-540).
- (xvi) The fruit trees are a 'horticultural plants' as defined in subsection 40-525(2). As Growers hold the land under a licence, one of the conditions in subsection 40-525(2) is met and a deduction for 'horticultural plants' is available under paragraph 40-515(1)(b) for their decline in value. The deduction for the fruit trees is determined using the formula in section 40-545 and is based on the capital expenditure incurred by the

Grower that is attributable to their establishment. The fruit trees have an ‘effective life’ of greater than 13 but fewer than 30 years for the purposes of section 40-545. This results in a straight-line write-off at a rate of 13%. The deduction is allowable when the fruit trees enter their first commercial season (section 40-530(2)).

Growers are not eligible to claim a deduction under these provisions for the trees already established on the Cawarrie Orchard. The applicant has advised that expenditure attributable to the establishment of these trees has been fully written off by the landowner. The Responsible Entity will inform Growers when the fruit trees established on the Roseville South Orchard enter their first commercial season.

## **Tax outcomes that apply to all Growers**

### **Shares**

63. Shares in the Landowning Company are ‘CGT assets’ (section 108-5) and the amount of \$1,000 per Ordinary share paid by a Grower to acquire the share is an outgoing of capital and is not allowable as a deduction. The amount paid for each share will represent the first element of the cost base of the share (subsection 110-25(2)).

64. Dividends paid out of profits by the Landowning Company are included in the assessable income of shareholders under section 44(1) of the ITAA 1936.

### **Interest**

65. The deductibility or otherwise of interest incurred by Growers who finance their participation in the Project through a loan facility with a bank or other financier is outside the scope of this Ruling. Product Rulings only rule on the deductibility of expenditure where all details and related documentation have been provided to, and examined by the Tax Office. However all Growers who borrow funds in order to participate in the Project, should read the discussion of the prepayment rules in paragraphs 89 to 112 (below) as those rules may be applicable if interest is prepaid. Subject to the ‘excluded expenditure’ exception, the prepayment rules apply whether the prepayment is required under the relevant loan agreement or is at the Grower’s choice.

**Division 35 – Deferral of losses from non-commercial business activities****Section 35-55 – Commissioner’s discretion**

66. For a Grower who is an individual and who enters the Project during the year ended 30 June 2002 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for these Growers for the income year ending 30 June 2002 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

67. For a Grower who is an individual and who enters the Project after 1 July 2001 but on or before 20 July 2001 the rule in section 35-10 may apply to the business activity comprised by their involvement in this Project. Under paragraph 35-55(1)(b) the Commissioner will decide for these Growers for the income year ending 30 June 2003 that the rule in section 35-10 does not apply to this activity provided that the Project is carried out in the manner described in this Ruling.

68. This exercise of the discretion in subsection 35-55(1) will not be required where, for any year in question:

- the ‘Exception’ in subsection 35-10(4) applies (see paragraph 119 in the Explanations part of this ruling, below).
- a Grower’s business activity satisfies one of the objective tests in sections 35-30, 35-35, 35-40 or 35-45; or
- the Grower’s business activity produces assessable income for an income year greater than the deductions attributable to it for that year (apart from the operation of subsection 35-10(2)); or
- the Commissioner is precluded from exercising the discretion under paragraph 35-55(1)(b) because of subsection 35-55(2).

69. Where, the exception in subsection 35-10(4) applies, the Grower’s business activity satisfies one of the tests, or the discretion in subsection 35-55(1) is exercised, section 35-10 will not apply. This means that a Grower will not be required to defer any excess of deductions attributable to their business activity in excess of any assessable income from that activity, i.e., any ‘loss’ from that activity, to a later year. Instead, this ‘loss’ can be offset against other assessable income for the year in which it arises.

70. Growers are reminded of the important statement made on Page 1 of this Product Ruling. Therefore, Growers should not see the

Commissioner's decision to exercise the discretion in paragraph 35-55(1)(b) as an indication that the Tax Office sanctions or guarantees the Project or the product to be commercially viable. An assessment of the Project or the product from this perspective has not been made.

## Section 82KL and Part IVA

71. For a Grower who participates in the Project and incurs expenditure as required by the Management Agreement and the Allotment Agreement the following provisions of the ITAA 1936 have application as indicated:

- section 82KL does not apply to deny the deductions otherwise allowable; and
- the relevant provisions in Part IVA will not be applied to cancel a tax benefit obtained under a tax law dealt with in this Ruling.

## Explanations

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### Is the Grower carrying on a business?

72. For the amounts set out in the Tables above to constitute allowable deductions the Grower's fruit growing activities as a participant in the Parkview Orchard Project Prospectus No 2 must amount to the carrying on of a business of primary production. These fruit growing activities will fall within the definitions of 'horticulture' and 'commercial horticulture' in section 40-535 of the ITAA 1997.

73. For schemes such as that of the Parkview Orchard Project Prospectus No 2, Taxation Ruling TR 2000/8 sets out in paragraph 89 the circumstances in which the Grower's activities can constitute the carrying on of a business. As Taxation Ruling TR 2000/8 sets out, these circumstances have been established in court decisions such as *FCT v. Lau* 84 ATC 4929.

74. Generally, a Grower will be carrying on a business of growing fruit, and hence primary production, if:

- the Grower has an identifiable interest (by lease or by licence) in the land on which the Grower's fruit trees are established;
- the Grower has a right to harvest and sell the fruit each year from those fruit trees;
- the fruit growing activities are carried out on the Grower's behalf; and

- the fruit growing activities of the Grower are typical of those associated with a fruit growing business; and
- the weight and influence of general indicators point to the carrying on of a business.

75. In this Project, each Grower enters into a Management Agreement and an Allotment Agreement.

76. Under the Allotment Agreement each individual Grower will have rights over a specific and identifiable area of land. The Allotment Agreement provides the Grower with an ongoing interest in the specific fruit trees on the licensed area for the term of the Project. Under the licence the Grower must use the land in question for the purpose of carrying out fruit growing activities and for no other purpose. The licence allows the Responsible Entity to come onto the land to carry out its obligations under the Management Agreement.

77. Under the Management Agreement the Responsible Entity is engaged by the Grower to establish and maintain an allotment on the Grower's identifiable area of land during the term of the Project. The Responsible Entity has provided evidence that it holds the appropriate professional skills and credentials to provide the management services to establish and maintain the allotment on the Grower's behalf.

78. In establishing the allotment, the Grower engages the Responsible Entity to purchase and install water facilities (e.g., irrigation), and to acquire and plant the fruit trees on the Grower's allotment. During the term of the Project, these assets will be used wholly to carry out the Grower's fruit growing activities. The Responsible Entity is also engaged to harvest and sell, on the Grower's behalf, the fruit grown on the Grower's allotment.

79. The general indicators of a business, as used by the Courts, are described in Taxation Ruling TR 97/11. Positive findings can be made from the Project's description for all the indicators.

80. The activities that will be regularly carried out during the term of the Project demonstrate a significant commercial purpose. Based on reasonable projections, a Grower in the Project will derive assessable income from the sale of its fruit that will return a before-tax profit, i.e., a profit in cash terms that does not depend in its calculation on the fees in question being allowed as a deduction.

81. The pooling of fruit grown on the Grower's allotment with the fruit of other Growers is consistent with general fruit growing practices. Each Grower's proportionate share of the sale proceeds of the pooled fruit will reflect the proportion of the fruit contributed from their allotment.

82. The Responsible Entity's services and the installation of assets on the Grower's behalf are also consistent with general fruit growing

practices. The assets are of the type ordinarily used in carrying on a business of fruit growing. While the size of a allotment is relatively small, it is of a size and scale to allow it to be commercially viable. (see Taxation Ruling IT 360).

83. The Grower's degree of control over the Responsible Entity as evidenced by the Management Agreement, and supplemented by the Corporations Act, is sufficient. During the term of the Project, the Manager will provide the Grower with regular progress reports on the Grower's allotment and the activities carried out on the Grower's behalf. Growers are able to terminate arrangements with the Responsible Entity in certain instances, such as cases of default or neglect.

84. The fruit growing activities, and hence the fees associated with their procurement, are consistent with an intention to commence regular activities that have an 'air of permanence' about them. For the purposes of this Ruling, the Growers' fruit growing activities in the Parkview Orchard Project Prospectus No 2 will constitute the carrying on of a business.

### **The Simplified Tax System - Division 328**

85. Subdivision 328-F sets out the eligibility requirements that a Grower must satisfy in order to enter the STS and Subdivision 328-G sets out the rules for entering and leaving the STS.

86. The question of whether a Grower is eligible to be an 'STS taxpayer' is outside the scope of this Product Ruling. Therefore, any Grower who relies on those parts of this Ruling that refer to the STS will be assumed to have correctly determined whether or not they are eligible to be an 'STS taxpayer'.

### **Deductibility of Management fees, Picking, Packing and Marketing fees and Licence fees - section 8-1**

87. Consideration of whether the Initial Management fees, Picking, Packing and Marketing fees and Licence fees are deductible under section 8-1 begins with the first limb of the section. This view proceeds on the following basis:

- the outgoing in question must have a sufficient connection with the operations or activities that directly gain or produce the taxpayer's assessable income;
- the outgoings are not deductible under the second limb if they are incurred when the business has not commenced; and

- where all that happens in a year of income is that a taxpayer is contractually committed to a venture that may not turn out to be a business, there can be doubt about whether the relevant business has commenced, and hence, whether the second limb applies. However, that does not preclude the application of the first limb in determining whether the outgoing in question has a sufficient connection with activities to produce assessable income.

88. The Management fees, Picking, Packing and Marketing fees and Licence fees associated with the fruit growing activities will relate to the gaining of income from the Grower's business of growing fruit (see above), and hence have a sufficient connection to the operations by which income (from the regular sale of fruit) is to be gained from this business. They will thus be deductible under the first limb of section 8-1. Further, no 'non-income producing' purpose in incurring the fee is identifiable from the arrangement. The fee appears to be reasonable. There is no capital component of the management fee, other than the amounts identified at paragraph 30. The tests of deductibility under the first limb of section 8-1 are met. The exclusions do not apply.

#### **Prepayment provisions - sections 82KZL to 82KZMF**

89. The prepayment provisions contained in Subdivision H of Division 3 of Part III of the ITAA 1936 affect the timing of deductions for certain prepaid expenditure. These provisions apply to certain expenditure incurred under an agreement in return for the doing of a thing under the agreement (e.g., the performance of management services or the leasing of land) that will not be wholly done within the same year of income as the year in which the expenditure is incurred. If expenditure is incurred to cover the provision of services to be provided within the same year, then it is not expenditure to which the prepayment rules apply.

90. For projects such as the Parkview Orchard Project, the prepayment rules in sections 82KZME and 82KZMF will usually apply. In an income year where sections 82KZME and 82KZMF do not apply because one or more of the requirements of those provisions are not met, deductions for prepaid expenditure are considered under sections 82KZMA and 82KZMD (for taxpayers who are not 'STS taxpayers) or, alternatively, under section 82KZM (for taxpayers who are 'STS taxpayers').

## Sections 82KZME and 82KZMF

91. Where the requirements of subsections 82KZME(2) and (3) are met, the formula in subsection 82KZMF(1) (see below) will apply to apportion expenditure that is otherwise deductible under section 8-1 of the ITAA 1997. These provisions also apply to 'STS taxpayers' because there is no specific exclusion contained in section 82KZME that excludes them from the operation of section 82KZMF.

92. The requirements of subsection 82KZME(2) will be met if expenditure is incurred by a taxpayer in return for the doing of a thing that is not to be wholly done within the year the expenditure is made. The year in which such expenditure is incurred is called the 'expenditure year' (subsection 82KZME(1)).

93. The requirements of subsection 82KZME(3) will be met where the agreement (or arrangement) has the following characteristics:

- (a) the taxpayer's allowable deductions under the agreement for the 'expenditure year' exceed any assessable income attributable to the agreement for that year;
- (b) the taxpayer does not have effective day to day control over the operation of the agreement. That is, the significant aspects of the arrangement are managed by someone other than the taxpayer; and
- (c) either:
  - (i) there is more than one participant in the agreement in the same capacity as the taxpayer; or
  - (ii) the person who promotes, arranges or manages the agreement (or an associate of that person) promotes similar agreements for other taxpayers.

94. For the purpose of these provisions, the agreement includes all activities that relate to the agreement (subsection 82KZME(4)). This has particular relevance for a Grower in this Project who, in order to participate in the Project may borrow funds from a financier. Although undertaken with an unrelated party, that financing would be an element of the arrangement. The funds borrowed and the interest deduction are directly related to the activities under the arrangement. If a Grower prepays interest under such financing arrangements, the deductions allowable will be subject to apportionment under section 82KZMF.

95. There are a number of exceptions to these rules, but for Growers participating in this Project, only the 'excluded expenditure' exception in subsection 82KZME(7) is relevant. 'Excluded

expenditure' is defined in subsection 82KZL(1). However, for the purposes of Growers in this Project, 'excluded expenditure' is prepaid expenditure incurred under the arrangement that is less than \$1,000. Such expenditure is immediately deductible.

96. Where the requirements of section 82KZME are met, section 82KZMF applies to apportion relevant prepaid expenditure, unless the 'excluded expenditure' exception applies.

Section 82KZMF uses the formula below, to apportion prepaid expenditure and allow a deduction over the period that the benefits are provided.

$$\text{Expenditure X} \frac{\text{Number of days of eligible service}}{\text{Total number of days of eligible service period}} \times \text{period in the year of income}$$

97. In the formula 'eligible service period' (defined in subsection 82KZL(1)) means the period during which the thing under the agreement is to be done. The 'eligible service period' begins on the day on which the thing under the agreement commences to be done or on the day on which the expenditure is incurred, whichever is the later, and ends on the last day on which the thing under the agreement ceases to be done, up to a maximum of 10 years.

### ***Application of sections 82KZME and 82KZMF to Growers in this Project***

98. In each year of the Parkview Orchard Project the expenditure of all Growers meets the requirements of subsection 82KZME(2). However, while the arrangement in this Project meets the requirements of subsection 82KZME(3) for the first income year in which a Grower participates, it may not meet the requirement in paragraph 82KZME(3)(a) for the second and/or the third income year in which a Grower participates. In those years, the income and expenditure projections provided by the applicant indicate that assessable income under the agreement will exceed allowable deductions attributable to the agreement. If this occurs, section 82KZMF and the formula in subsection 82KZMF(1) will have no application for those income years.

99. For the first income year all Growers will calculate deductions for the prepaid Management fee of \$7,008 using the formula in subsection 82KZMF(1) (see above).

100. For Growers that acquire the minimum allocation of one interest, the prepaid Licence fee of \$110 in the first income year will be 'excluded expenditure' (subsection 82KZME(7)). A Grower who is an 'STS taxpayer' can claim an immediate deduction for the Licence fee in the income year in which it is paid. A Grower who is not an

‘STS taxpayer’ can claim an immediate deduction for the Licence fee in the income year in which it is incurred.

101. However, where a Grower acquires more than the minimum allocation of one interest in the Project, the quantum of the prepaid Licence fees may be \$1,000 or more. Where this occurs, the deduction allowable for the prepaid Licence fee in the first year will also be subject to apportionment according to the formula in subsection 82KZMF(1).

### **Prepaid fees for the second and third income years for a Grower who is not an ‘STS taxpayer’**

102. The following paragraphs assume that the income and expenditure projections provided by the applicant will be met. However, if those projections are not met, and the allowable deductions attributable to the agreement exceed assessable income under the agreement in the second and/or third income years, the following paragraphs will have no relevance and deductions for prepaid fees in the relevant year will be calculated under sections 82KZME and 82KZMF (see paragraphs 91 to 101). Where sections 82KZME and 82KZMF do not apply, Growers who are not STS taxpayers will determine deductions for prepaid expenditure under sections 82KZMA to 82KZMD.

103. For a Grower who acquires the minimum allocation of one allotment, the prepaid Management fee of \$600 (CPI adjusted) for the second year and \$700 (CPI adjusted) for the third year and the Picking, Packing and Marketing fee of \$600 (CPI adjusted) for the second year and \$700 (CPI adjusted) for the third year is ‘excluded expenditure’. ‘Excluded expenditure’ is not subject to apportionment (subsection 82KZMA(4)). It is deductible in the year in which it is incurred.

104. However, where a Grower acquires more than the minimum allocation of two interests in the Project, the quantum of these prepaid fees may be \$1,000 or more. Where this occurs, the Grower will be required to determine the deduction allowable for the prepaid fees under sections 82KZMA to 82KZMD.

105. For the income year ended 30 June 2003, transitional provisions contained in sections 82KZMB and 82KZMC may apply. The application of those provisions is complex and will depend upon a number of factors. Individual participants affected by these provisions may ask the Tax Office for a private ruling on how these provisions will apply to their individual circumstances.

106. For the income year ended 30 June 2004, the transitional arrangements in sections 82KZMB and 82KZMC will have no application as those provisions are repealed once the transitional

period expires. Where the relevant year is the income year ended 30 June 2004, prepaid expenditure that is not 'excluded expenditure' is apportioned using the formula in subsection 82KZMD(2). That formula is shown below:

$$\text{Expenditure} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

### **Prepaid fees for the second and third income years for a Grower who is an 'STS taxpayer'**

107. The following paragraphs assume that the income and expenditure projections provided by the applicant will be met. However, if those projections are not met, and the allowable deductions attributable to the agreement exceed assessable income under the agreement in the second and/or third income years, the following paragraphs have no relevance and deductions for prepaid fees in the relevant year will be determined under sections 82KZME and 82KZMF (see paragraphs 91 to 101).

108. For a Grower who is an 'STS taxpayer', the prepaid Management fee of \$600 (CPI adjusted) for the second year and \$700 (CPI adjusted) for the third year, and the Picking, Packing and Marketing fee of \$600 (CPI adjusted) for the second year and \$700 (CPI adjusted) for the third year, will be deductible in the year in which they are paid by, or on behalf of, the Grower (paragraph 328-105(1)(b)). However, paragraph 328-105(1)(b) does not apply if another provision would allow the deduction at a different time (section 328-105(2)). For 'STS taxpayers' the prepayment rules in section 82KZM are such a provision and may, in certain circumstances, apply to a Grower in this Project.

109. Section 82KZM will apply to apportion prepaid expenditure incurred by an 'STS taxpayer' that is otherwise deductible under section 8-1 where:

- the expenditure is not 'excluded expenditure'; and either
- the 'eligible service period' for the expenditure is longer than 12 months; or
- the 'eligible service period' for the expenditure is 12 months or shorter but ends after the last day of the year of income after the one in which the expenditure was incurred.

110. Where section 82KZM applies, the deduction for the expenditure is apportioned over the 'eligible service period' using the formula in subsection 82KZM(1). The formula is:

$$\frac{\text{Period in year}}{\text{Eligible service period}}$$

The 'period in year' is the number of days in the whole or the part of the 'eligible service period' that occurs in the year of income. The 'eligible service period' is explained in paragraph 97 (above).

111. Under the terms of the Project's Management agreement, the 'eligible service period' relating to the prepaid Management fee for the second and the third years and the prepaid Picking, Packing and Marketing fee for the second and the third years is exactly 12 months. Accordingly, section 82KZM will not apply to apportion the fees.

112. As section 82KZM has no application, the prepaid Management fees and the prepaid Picking, Packing and Marketing fees for the second and the third years will be deductible when paid by, or on behalf of, a Grower who is an 'STS taxpayer'. However, if such a Grower chooses to prepay those fees for a period of longer than 12 months and the quantum of each of these fees is \$1,000 or more, apportionment under 82KZM will be necessary.

### **Expenditure of a capital nature - Divisions 40 and 328**

113. Any part of the expenditure of a Grower that is attributable to acquiring an asset or advantage of an enduring kind is generally capital or capital in nature and will not be an allowable deduction under section 8-1. In this Project, expenditure attributable to water facilities and the establishment of fruit trees is of a capital nature. This expenditure falls for consideration under Division 40 or Division 328 of the ITAA 1997.

114. The application and extent to which a Grower claims deductions under Division 40 and Division 328 depends on whether or not the Grower is an 'STS taxpayer'.

115. The tax treatment of capital expenditure has been dealt with in a representative way in paragraphs 52 and 62 (above) in the Tables and the accompanying Notes.

### **Deferral of losses from non-commercial business activities - Division 35**

116. Division 35 applies to losses from certain business activities for the income year ended 30 June 2001 and subsequent years. Under the rule in subsection 35-10(2), a deduction for a loss made by an individual (including an individual in a general law partnership) from

certain business activities will not be taken into account in an income year unless:

- the exception in subsection 35-10(4) applies;
- one of four tests in sections 35-30, 35-35, 35-40 or 35-45 is met; or
- if one of the tests is not satisfied, the Commissioner exercises the discretion in section 35-55.

117. Generally, a loss in this context is, for the income year in question, the excess of an individual taxpayer's allowable deductions attributable to the business activity over that taxpayer's assessable income from the business activity.

118. Losses that cannot be taken into account in a particular year of income, because of subsection 35-10(2), can be applied to the extent of future profits from the business activity, or are deferred until one of the tests is passed, the discretion is exercised, or the exception applies.

119. For the purposes of applying Division 35, subsection 35-10(3) allows taxpayers to group business activities 'of a similar kind'. Under subsection 35-10(4), there is an 'exception' to the general rule in subsection 35-10(2) where the loss is from a primary production business activity and the individual taxpayer has other assessable income for the income year from sources not related to that activity, of less than \$40,000 (excluding any net capital gain). As both subsections relate to the individual circumstances of Growers who participate in the Project they are beyond the scope of this Product Ruling and are not considered further.

120. In broad terms, the objective tests require:

- (a) at least \$20,000 of assessable income in that year from the business activity (section 35-30);
- (b) the business activity results in a taxation profit in 3 of the past 5 income years (including the current year)(section 35-35);
- (c) at least \$500,000 of real property is used on a continuing basis in carrying on the business activity in that year (section 35-40); or
- (d) at least \$100,000 of certain other assets are used on a continuing basis in carrying on the business activity in that year (section 35-45).

121. A Grower who participates in the Project will be carrying on a business activity that is subject to these provisions. Information provided with the application for this Product Ruling indicates that a Grower who acquires the minimum allocation of one allotment in the Project is unlikely to have their activity pass one of the objective tests

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until the income year ended 30 June 2005. Growers who acquire more than one interest in the Project may however, find that their activity meets one of the tests in an earlier income year.

122. Therefore, prior to this time, unless the Commissioner exercises an arm of the discretion under paragraphs 35-55(1)(a) or (b), the rule in subsection 35-10(2) will apply to defer to a future income year any loss that arises from the Grower's participation in the Project.

123. The first arm of the discretion in paragraph 35-55(1)(a) relates to 'special circumstances' applicable to the business activity, and has no relevance for the purposes of this Product Ruling. However, the second arm of the discretion in paragraph 35-55(1)(b) may be exercised by the Commissioner where:

- (i) the business activity has started to be carried on;
- (ii) because of its nature, it has not satisfied one of the objective tests; and
- (iii) there is an objective expectation that the business activity of an individual taxpayer will either pass one of the objective tests or produce a taxation profit within a period that is commercially viable for the industry concerned.

124. Information provided with this Product Ruling indicates that a Grower who is accepted into the Project on or before the 30 June 2002 and who acquires the minimum allocation of one allotment in the Project is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2003. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for income year ended 30 June 2002.

125. Alternatively, where a Grower who acquires the minimum allocation of one allotment is accepted into the Project between 1 July 2002 and 20 July 2002 (inclusive) is expected to be carrying on a business activity that will either pass one of the objective tests, or produce a taxation profit, for the year ended 30 June 2004. The Commissioner will decide for such a Grower that it would be reasonable to exercise the second arm of the discretion for income year ended 30 June 2003.

126. This Product Ruling is issued on a prospective basis (i.e., before an individual Grower's business activity starts to be carried on). The Project, however, may fail to be carried on during the income years specified above (see paragraph 66 and 67), in the manner described in the Arrangement (see paragraphs 14 to 34). If so, this Ruling, and specifically the decision in relation to paragraph 35-55(1)(b), that it would be unreasonable that the loss deferral rule in subsection 35-10(2) not apply, may be affected, because the Ruling no

longer applies (see paragraph 9). Growers may need to apply for private rulings on how paragraph 35-55(1)(b) will apply in such changed circumstances.

127. In deciding that the second arm of the discretion in paragraph 35-55(1)(b) will be exercised on this conditional basis, the Commissioner has relied upon:

- the report of the independent horticulturalist; and
- independent, objective, and generally available information relating to fruit growing which substantially supports cash flow projections and other claims, including prices and costs, in the Product Ruling application submitted by the Responsible Entity.
- other expert opinion independently obtained by the Commissioner that specifically relates to the Project.

#### **Section 82KL - recouped expenditure**

128. Section 82KL is a specific anti-avoidance provision that operates to deny an otherwise allowable deduction for certain expenditure incurred, but effectively recouped, by the taxpayer. Under subsection 82KL(1), a deduction for certain expenditure is disallowed where the sum of the 'additional benefit' plus the 'expected tax saving' in relation to that expenditure equals or exceeds the 'eligible relevant expenditure'.

129. 'Additional benefit' (see the definition of 'additional benefit' at subsection 82KH(1) and paragraph 82KH(1F)(b)) is, broadly speaking, a benefit that is additional to the benefit for which the expenditure is ostensibly incurred. The 'expected tax saving' is essentially the tax saved if a deduction is allowed for the relevant expenditure.

130. Section 82KL's operation depends, among other things, on the identification of a certain quantum of 'additional benefits'. Here, there may be a loan provided to the Grower. The loan will be provided on a full recourse basis, and on commercial terms. Insufficient 'additional benefits' will be provided in respect of this Project, to trigger the application of section 82KL. It will not apply to deny the deductions otherwise allowable under section 8-1.

#### **Part IVA - general tax avoidance provisions**

131. For Part IVA to apply there must be a 'scheme' (section 177A), a 'tax benefit' (section 177C) and a dominant purpose of entering into the scheme to obtain a tax benefit (section 177D).

132. The Parkview Orchard Project Prospectus No 2 will be a 'scheme'. A Grower will obtain a 'tax benefit' from entering into the scheme, in the form of tax deductions for the amounts detailed at paragraphs 50, 52, 58 and 62 that would not have been obtained but for the scheme. However, it is not possible to conclude the scheme will be entered into or carried out with the dominant purpose of obtaining this tax benefit.

133. Growers to whom this Ruling applies intend to stay in the scheme for its full term and derive assessable income from the harvesting and sale of the fruit. There are no facts that would suggest that Growers have the opportunity of obtaining a tax advantage other than the tax advantages identified in this Ruling. There is no non-recourse financing or round robin characteristics, and no indication that the parties are not dealing at arm's length or, if any parties are not dealing at arm's length, that any adverse tax consequences result. Further, having regard to the factors to be considered under paragraph 177D(b) it cannot be concluded, on the information available, that participants will enter into the scheme for the dominant purpose of obtaining a tax benefit.

## Examples

### Example 1 - Entitlement to GST input tax credits

134. Susan, who is a sole trader and registered for GST, contracts with a manager to manage her viticulture business. Her manager is registered for GST and charges her a management fee payable every six months in advance. On 1 December 2001 Susan receives a valid tax invoice from her manager requesting payment of a management fee in advance, and also requesting payment for an improvement in the connection of electricity for her vineyard that she contracted him to carry out. The tax invoice includes the following details:

Management fee for period 1/1/2002 to 30/6/2002	\$4 400*
Carrying out of upgrade of power for your vineyard as quoted	<u>\$2 200*</u>
Total due and payable by 1 January 2002 (includes GST of \$600)	<u>\$6 600</u>

\*Taxable supply

Susan pays the invoice by the due date and calculates her input tax credit on the management fee (to be claimed through her Business Activity Statement) as:

$$1/11 \times \$4400 = \$400.$$

Hence her outgoing for the management fee is effectively \$4400 less \$400, or \$4000.

Similarly, Susan calculates her input tax credit on the connection of electricity as:

$$1/11 \times \$2200 = \$200.$$

Hence her outgoing for the power upgrade is effectively \$2200 less \$200, or \$2000.

In preparing her income tax return for the year ended 30 June 2002, Susan is aware that the management fee is deductible in the year incurred. She calculates her management fee deduction as \$4000 (not \$4400).

Susan is aware that the electricity upgrade is deductible 10% per year over a 10 year period. She calculates her deduction for the power upgrade as \$200 (one tenth of \$2000 only, not one tenth of \$2200).

### **Example 2 – Apportionment of Fees**

135. Murray decides to participate in the ABC Pineforest Prospectus which is offering 500 interests of 0.5ha in an afforestation project of 25 years. The management fees are \$5,000 in the first year and \$1,200 for years 2 and 3. From year 4 onwards the management fee will be the previous year's fee increased by the CPI. The first year's fees are payable on execution of the agreements for services to be provided in the following 12 months and thereafter, the fees are payable in advance each year on the anniversary of that date. The project is subject to a minimum subscription of 300 interests. Murray provides the Responsible Entity with a 'Power of Attorney' allowing the Manager to execute his Management Agreement and the other relevant agreements on his behalf. On 5 June 2002 the Responsible Entity informs Murray that the minimum subscription has been reached and the Project will go ahead. Murray's agreements are duly executed and management services start to be provided on that date.

Murray is an 'STS taxpayer' who is not registered, nor required to be registered for GST. He calculates his tax deduction for management fees for the **2002 income year** as follows:

$$\text{Management fee} \times \frac{\text{Number of days of eligible service period in the year of income}}{\text{Total number of days of eligible service period}}$$

$$\$5,000 \times \frac{26}{365}$$

= **\$356** (this is Murray's total tax deduction in 2002 for the Year 1 prepaid management fees of \$5,000. It represents the 26 days for which management services were provided in the 2002 income year).

In the **2003 income year** Murray will be able to claim a tax deduction for management fees calculated as the sum of two separate amounts:

$$\$5,000 \times \frac{339}{365}$$

= **\$4,644** (this represents the balance of the Year 1 prepaid fees for services provided to Murray in the 2003 income year).

$$\$1,200 \times \frac{26}{365}$$

= **\$85** (this represents the portion of the Year 2 prepaid management fees for the 26 days during which services were provided to Murray in the 2003 income year).

**\$4,644 + \$85 = \$4,729** (The sum of these two amounts is Murray's total tax deduction for management fees in 2003).

Murray continues to calculate his tax deduction for prepaid management fees using this method for the term of the Project.

**Example 3 – Apportionment of fees where there is a contractual ‘eligible service period’ and the fees include expenditure that is ‘excluded expenditure’**

136. On 1 June 2002 Kevin applies for an interest into the Western Bluegum Project, a prospectus based afforestation project of 12 years. Kevin is accepted into the project and executes a lease and management agreement with the Responsible Entity for the provision of management services and the lease of his Woodlot. The terms of the lease and management agreement require Kevin to prepay the management fees and the lease fee on or before the 30 June each year for the lease of his Woodlot and the provision of management services between the 1 July and 30 June in the following income year. Kevin pays the first year management fee of \$3,600 and first year lease fee of \$500 on 15 June 2002.

Kevin, who is not an ‘STS taxpayer’ is not registered, nor required to be registered for GST.

He calculates his tax deduction for management fees and the lease fee for the **2002 income year** as follows:

*Management fee*

Even though he paid the \$3,600 in the 2002 income year, because there are no ‘days of eligible service period’ in that year, Kevin is unable to claim any part of his management fees as a tax deduction in his tax return for the year ended 30 June 2002.

*Lease fee*

Because the \$500 lease fee is less than \$1,000 it is 'excluded expenditure' and can be claimed in full as a tax deduction in Kevin's tax return for the year ended 30 June 2002.

In the **2003 income year** Kevin can claim a tax deduction for his first year's management fees calculated as follows:

$$\$3,600 \times \frac{365}{365}$$

= **\$3,600** (this represents the whole of the first year's management fee prepaid in the 2002 income year but not deductible until the 2003 income year).

For the term of the Project Kevin continues to calculate his tax deduction for prepaid fees using this method.

## **Detailed contents list**

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**Commissioner of Taxation**

16 January 2002

*Previous draft:*

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*Related Rulings/Determinations:*

PR 1999/95; PR 2000/71; TR 92/1;  
TR 92/20; TR 97/11; TR 97/16;  
TR 98/22; TR 2000/8; TD 93/34;  
IT 360

*Subject references:*

- carrying on a business
- commencement of business
- primary production
- primary production expenses
- management fee expenses
- producing assessable income
- product rulings
- public rulings
- schemes and shams
- taxation administration
- tax avoidance
- tax benefits under tax avoidance
- schemes

- tax shelters

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- ITAA 1936 82KZME(2)
- ITAA 1936 82KZME(3)
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